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C O N F I D E N T I A L SECTION 01 OF 04 CARACAS 000217

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TREASURY FOR KLINGENSMITH AND NGRANT
COMMERCE FOR 4431/MAC/WH/MCAMERON
NSC FOR DTOMLINSON
ENERGY FOR CDAY, DPUMPHERY, AND ALOCKWOOD
HQ SOUTHCOM ALSO FOR POLAD
EB/IFD/OIA
L/CID

E.O. 12958: DECL: 01/22/2016
TAGS: EINV PGOV ECON VE
SUBJECT: INTERNATIONAL ARBITRATION VS. THE BRV

REF: A. CARACAS 59

¶B. CARACAS 84
¶C. CARACAS 132

CARACAS 00000217 001.2 OF 004

Classified By: Andrew N. Bowen, Economic Counselor, for reasons 1.4(b) and (d).

¶1. (C) Summary: International arbitration will become increasingly important to foreign investors as Chavez moves forward with his selective nationalizations and disputes over "prompt, adequate, and effective compensation" arise. Foreign investors have three options to avail themselves of arbitration rights - bilateral investment treaties (BITs), contractual provisions providing for international commercial arbitration, and domestic law. BITS seem to offer investors the best chance of ensuring the BRV's cooperation in the proceedings and enforcing an arbitration award. The BRV's track record of compliance with treaty arbitration is stronger than commercial arbitration and the business ramifications of non-compliance would be far greater. Though the United States and the BRV have not signed a BIT, some U.S. investors, such as Verizon and AES, operate through subsidiaries that could claim BIT protection. The BRV's reluctance to enforce international commercial arbitration awards may make U.S. courts the final stop for many investors, in an attempt to attach BRV assets located in the United States. End Summary.

A Robust Legal Market: Changes Ahead

¶2. (C) Econoffs met separately with legal counsel from two prominent law firms in Caracas, Elisabeth Eljuri and Victorino Tejera from the Canadian oil and gas firm Macleod Dixon, and Hernando Diaz and Bernardo Weininger from the Cleveland-based firm Squire Sanders (strictly protect). Both firms told Econoffs that they were left guessing as to exactly where Chavez was heading in terms of legal reform, but that consequently, business was booming. Eljuri said that her phone was ringing off the hook with clients

inquiring as to the business climate in Venezuela and what their best options would be to protect investments. In particular, dispute resolution and arbitration practices of major firms stand to gain a lot of business. The U.S. firm Latham and Watkins, whose partner was counsel for the U.S. Export-Import Bank on the Hamaca strategic association in the Faja, published an article in early January 2007 outlining foreign companies' options under international arbitration in Venezuela, with the expectation that Chavez' nationalization campaign will generate a lot of legal work. Latham did not discuss provisions in BRV domestic law for arbitration and suggested that the two options available to foreign investors would be (1) investment treaty arbitration, and (2) international commercial arbitration.

¶3. (C) Eljuri, a Harvard-educated attorney admitted to the N.Y. Bar, said the BRV was generally wary of international arbitration and would, in her view, move quickly to enact legal changes to try to limit foreign investors' rights to arbitration. As a practical matter, both firms told us that currently it is almost impossible to negotiate an international arbitration clause in a contract with a state-controlled entity. Eljuri suggested that refusing to recognize the validity of commercial arbitration claims in BRV courts may be one of the constitutional changes Chavez will put forward.

Treaty Arbitration vs. Commercial Arbitration

¶4. (U) We will discuss two types of international arbitration that appear to be available for investors: treaty arbitration and commercial arbitration. Treaty arbitration refers to arbitration proceedings in which the underlying claim stems from a state's alleged breach of its obligations

under an international treaty -- generally, a BIT. These claims are submitted to the International Center for Settlement of Investment Disputes (ICSID), an independent organization affiliated with the World Bank. International commercial arbitration refers to resolving commercial disputes between transnational actors (whether private parties or states) pursuant to the terms of an arbitration clause in the underlying agreement. In contrast to ICSID's set rules and procedure, the parties themselves determine the procedural rules applicable to the commercial dispute. Parties will generally elect institutional arbitration, such as the International Chamber of Commerce, International Court of Arbitration, or London Court of International Arbitration.

BITs: Treaty Arbitration

¶5. (C) Venezuela is a signatory to the multilateral ICSID Convention and has entered into BITs with more than 20 countries, though not with the United States. Investors that qualify as nationals of countries with which the BRV has signed a BIT can bring arbitration claims against the BRV, or state-controlled entities, to ICSID. U.S. companies may still benefit from BIT protection if they operate through subsidiaries incorporated in jurisdictions that have a BIT with the BRV, such as the Netherlands or Canada. Verizon and AES own their 28.5 percent stake in CANTV, and 82 percent interest in Electricidad de Caracas (EDC), respectively, through non-consolidated subsidiaries incorporated under Dutch law. Both could assert arbitration rights under the BRV-Dutch BIT and pursue ICSID arbitration claims against the BRV. (Note: We have heard that some U.S. investors have hired local legal counsel to register existing investments through such vehicles. End note.)

¶6. (C) Failure to cooperate in ICSID arbitration proceedings or to enforce an arbitration award in court would constitute a violation of both the bilateral BIT and the multilateral ICSID Convention, setting the BRV up as the pariah of the international business and legal community. ICSID arbitration proceedings are published on the World Bank website and the public nature of the process, in contrast to commercial arbitration which is strictly confidential, would make BRV non-compliance immediately and widely known. Blatant disregard for an ICSID award would make foreign counterparts wary of entering into any type of commercial relationship with the BRV. The limited track record to date suggests that the BRV has a decent record with respect to compliance with mandatory treaty arbitration provisions. The BRV is currently involved in three pending ICSID proceedings with Vanessa Ventures, Ltd., a Canadian mining exploitation company, the Vestey Group Ltd., a UK food production company, and I&I Beheer, a Dutch energy company. (Note: Vestey has suspended its claim as it reportedly has reached a settlement with the BRV. End note.)

International Commercial Arbitration

¶7. (C) Investors may elect international commercial arbitration, assuming that the underlying contracts provide for it. The New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards, signed by the United States and the BRV, calls for signatory states to enforce international arbitration awards in their domestic courts. The 1991 CANTV privatization agreement, by which Verizon acquired its interest in CANTV, reportedly contains an international arbitration clause, and we understand that all of the operating agreements for the strategic associations in the Faja provide for international arbitration.

¶8. (C) Recent case law with respect to international commercial arbitration suggests that foreign investors will

have a difficult time enforcing awards in Venezuelan courts. In a February 2006 decision involving Haagen-Dazs, BRV courts invalidated an American Arbitration Association award entered in Miami. The President of the Constitutional Chamber of the Supreme Court wrote a dissenting opinion stating that the court had acted in complete disregard for the Venezuelan legal system and in fulfilling international obligations. In April 2006, a BRV court set aside an International Court of Arbitration award entered in favor of an Italian electronics company against VTV, the state-owned television channel, in connection with a concession agreement. The court said that the arbitration agreement was not authorized in conformity with a 1998 Venezuelan Commercial Arbitration Law, even though the agreement pre-dated the law. The arbitrators involved were also called in to "explain themselves" before the BRV court.

¶9. (C) Comment: International commercial arbitration offers far weaker prospects for the investor than treaty arbitration. The New York Convention contains a provision excluding enforcement based on public policy concerns, a possible out for BRV courts. The BRV's contrasting treatment of commercial arbitration and BIT arbitration shows that the New York Convention doesn't have the same muscle that BITs do. Because commercial arbitration proceedings are confidential, the BRV could drag its feet on cooperating

without outside pressure. End Comment.

BRV Investment Promotion Law

¶10. (C) Domestic legislation in the BRV provides protection, in theory, to foreign investors through the 1999 Investment Promotion Law. The law offers similar protection as BITs, protecting against expropriation or equivalent measures, requiring fair and equitable treatment for foreign investors, most-favored nation treatment (MFN) and free transfer of investment returns. It does not allow investors to opt for international arbitration, unless they can otherwise qualify through a BIT, but permits them to bring claims to a domestic arbitration tribunal. The international law firm Freshfields Bruckhaus Deringer, counsel to I&I Beheer and Vestey in their arbitration claims, speculated that the MFN provisions contained in this law may give rights to other ICSID Convention signatory states to pursue ICSID arbitration, even in the absence of a BIT with the BRV. (Comment: While this is an attractive legal argument because of the ramifications for U.S. investors and legal practices, this claim is highly speculative and creative. Our reading of the Investment Promotion Law is that investors only have rights to ICSID arbitration if they can qualify under a BIT. End Comment.)

¶11. (C) Comment: While the 1999 Investment Promotion Law provides -- in theory -- for similar investor protection as under BITs, it is hard to see a foreign investor getting very far by relying on domestic law in light of the legal system's attitude towards arbitration and an increasingly politicized judiciary, especially vulnerable to pressure from the President. If the VTV decision is any indication, the BRV would not hesitate to invalidate arbitration rights that pre-date any legal or constitutional changes that may be on the way. End Comment.

The Oil Sector

¶12. (C) The 2001 Hydrocarbons Law takes major steps towards denying international arbitration rights to foreign investors altogether. The law requires disputes to be settled by BRV courts and "may not give rise to any foreign claims for any reason whatsoever." U.S. oil companies formed their heavy-oil strategic associations with PDVSA prior to 2001 and their agreements have arbitration clauses. If these companies were required to re-negotiate their existing

relationships to fit the Hydrocarbons Law, as the BRV has been pressuring, it would be important for them to expressly protect their arbitration rights. Our reading of the law's catch-all repudiation of arbitration in the oil sector is that it is meant to nullify arbitration rights under BITs as well. (Note: The law's dispute resolution framework is tantamount to unilateral repudiation of a BIT. Since BITs constitute treaty obligations of the BRV, any attempt to curtail investor rights thereunder via a domestic law could be considered as a violation of international law. End Note.)

Enforcement in the United States

¶13. (C) Investors may turn to U.S. courts to enforce commercial arbitration awards, given the uphill legal battle they would face in Venezuela. Econoffs asked Eljuri how easy it would be to attach BRV assets in the United States to satisfy an arbitration award. She responded that, in her view, "it would be difficult, though not impossible." (Note: U.S. courts have traditionally made it difficult to sue foreign sovereigns. Plaintiffs typically encounter subject matter and jurisdictional obstacles such as the Act of State

Doctrine and the Foreign Sovereign Immunities Act. However, enforcing an arbitration award should be more straightforward. U.S. courts will not apply the Act of State Doctrine in reviewing arbitration awards and consent to international arbitration is generally construed as a waiver of sovereign immunity. While PDVSA directly owns some assets in the United States, and petroleum tankers frequently call on U.S. ports, the most significant BRV asset in the United States is Citgo Petroleum Corporation. In determining whether an investor could attach Citgo assets, U.S. courts would likely consider several factors such as Citgo's management and ownership structure, and whether Citgo has acted as an instrumentality of the BRV. End note.)

Comment

¶14. (C) Arbitration is a predictable target for the BRV because it smacks of "imperialism" according to the BRV world view, imposing rights under international legal principles above those provided by domestic law. If recent case law and the 2001 Hydrocarbons Law are indicative, which we believe they are, Chavez would probably happily do away with recognition of arbitration awards entirely if he could. Foreign investors' best recourse may be to try to find legal protection under a BIT. BIT arbitration seems to be one area where the BRV has tread cautiously, despite its bull in a china shop approach to international law. If U.S. companies are unable to find protection under BITs and are left with commercial arbitration as their best option, they may be left with little choice than to start preparing legal briefs to enforce arbitration awards in U.S. courts.

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